

been decided through arbitration, SWBT has attempted to work with the arbitrating LSPs to develop contract language incorporating the results of arbitrated decisions expeditiously.

21. Since passage of the Act, employees involved directly in negotiations and in positions supporting those negotiations have worked tirelessly to respond to LSPs. In my 24 years with Southwestern Bell, I have never witnessed such a sustained effort and such dedication to a task. When a member of a negotiating team is not satisfied with the reasonableness of the SWBT position, that individual typically insists that we re-examine our position and satisfy ourselves that we are living up to our obligation to negotiate in good faith.

AGREEMENTS REACHED THROUGH NEGOTIATIONS (AS OF 4/4/97)

22. SWBT has responded to requests for negotiations from 136 companies wishing to become local service providers. The negotiations have the potential to produce 277 state interconnection/resale agreements in SWBT's five state service area including 44 agreements in Oklahoma, 102 agreements in Texas, 49 agreements in Missouri, 45 agreements in Kansas, and 37 agreements in Arkansas. To date, SWBT has reached agreement with 50 companies resulting in 89 mutually acceptable signed state agreements as a result of negotiations and/or arbitration. SWBT is continuing to negotiate with the other companies by addressing the specific needs of the requesting LSP, and expects the negotiations to culminate in approved agreements for the specific state requested by the LSP within the allowed timeframe outlined in the Act.

23. Since the Act went into effect on February 8, 1996, SWBT account managers have kept a tally of the negotiation and subcommittee meetings that have been held with LSPs. To date there have been 493 negotiations and 557 subcommittee meetings held to further negotiations.

24. SWBT has entered sixteen agreements with LSPs in Oklahoma, of which five are interconnection agreements and eleven are purely resale agreements. All of these signed interconnection agreements have been filed with the Oklahoma Corporation Commission (OCC) and four of the filed agreements have been approved as being in the public's best interest and in compliance with the Act. The approved interconnection agreements are with Sprint, ICG, Brooks Fiber Communications and US Long Distance (USLD). SWBT and Brooks have agreed to interconnect SWBT's tandems to Brook's switches in Tulsa and Oklahoma City utilizing physical collocation, although other alternatives were made available, including virtual collocation, SONET based interconnection, mid-span fiber meet and leased facilities interconnection. Similarly, SWBT and USLD agreed to interconnect SWBT's tandem to USLD's switch in Oklahoma City. The filed interconnection agreement awaiting approval by the Oklahoma Corporation Commission is with Intermedia Communications. Of the eleven resale agreements in Oklahoma, two are approved by the OCC; seven are awaiting approval by the commission and two have been signed by both parties and the LSPs will determine when to file. The approved resale agreements are with Dobson Wireless and Western Oklahoma Long Distance while the agreements pending approval are with Fast Connections, Reconex, CapRock Communications, Preferred Carrier Systems, Chickasaw Telecom, US Telco, and Oklahoma Comm South. A resale agreement with TIE Communications has been reached but has not been filed with the commission at the LSP's request. On April 3, 1997, the OCC issued an order granting Capital Telecommunication's request to withdraw their application to approve resale agreement with Southwestern Bell.

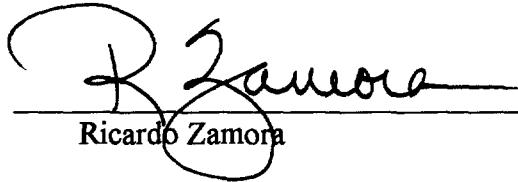
25. Sprint and SWBT entered a comprehensive interconnection agreement for Sprint's operations in Oklahoma on February 10, 1997. Local traffic will be exchanged at a mutual

and reciprocal rate for tandem served versus end office served interconnection. Sprint can choose from among various interconnection options, including physical collocation. Sprint can resell SWBT's Telecommunications Services at a wholesale discount of 19.8%, which the Oklahoma Corporation Commission (OCC) determined through arbitration to be the appropriate measure of SWBT's "avoided costs" of resale. In addition, Sprint can obtain SWBT's rebundled network elements (including unbundled loops, network interface devices, switching, transport, access to databases, and operational support systems) at cost-based rates. The SWBT/Sprint agreement is pending approval by the OCC.

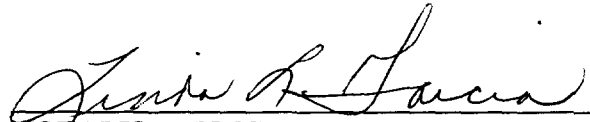
26. While SWBT and the local service providers negotiating agreements have been able to reach mutually acceptable language and prices in the vast majority of the contracts, there have been some issues that could not be settled and resulted in resolution through arbitration as provided for in the Act.
27. Though not immediately pertinent to this application, SWBT has signed a total of 89 agreements with LSPs outside of Oklahoma (36 in Texas, 12 in Missouri, 12 in Kansas, and 13 in Arkansas). These agreements, with such companies as AT&T, MFS, Sprint, TCG, Brooks Fiber, ACSI and dozens of other companies are detailed on the attached state by state schedule of signed contracts.
28. SWBT and AT&T are currently negotiating an interconnection agreement incorporating the compulsory arbitration award in OCC cause number 960000218. The Parties continue to discuss issues that were neither resolved through arbitration nor agreed to through negotiation. MCI requested negotiations for all five SWBT states, but filed for arbitration in Texas and Missouri only.
29. On a going forward basis, the negotiation process should become more streamlined for several reasons. First, over the course of the last year, all parties have gained a greater

understanding of what is expected under the Act. Second, any new entrant knows that it can step into another approved agreement or avail itself of SWBT's Statement of Generally Available Terms and Conditions if it wants to do so. In other words, tomorrow's LSPs will be able to take advantage of the work done and knowledge gained today by SWBT and existing LSPs. SWBT will continue to negotiate agreements as required by the Act for Oklahoma and the other states where it operates.

The information contained in this affidavit is true and correct to the best of my knowledge and belief.


Ricardo Zamora

Subscribed and sworn to before me this 9 day of april, 1997.


NOTARY PUBLIC

My commission expires:

LINDA L GARCIA
NOTARY PUBLIC STATE OF MISSOURI
ST. LOUIS CITY
MY COMMISSION EXP. JULY 23, 2000

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

In the matter of)	
)	
Application of SBC Communications Inc.,)	
Southwestern Bell Telephone Company,)	CC Docket No. _____
and Southwestern Bell Communications)	
Services, Inc., for Provision of In-Region,)	
InterLATA Services in Oklahoma)	

AFFIDAVIT OF KENNETH GORDON

KENNETH GORDON, being duly sworn, deposes and says:

I. STATEMENT OF QUALIFICATIONS

1. I am Senior Vice President of National Economic Research Associates, Inc. (NERA), One Main Street, Cambridge, MA 02142, and have held that position since November of 1995. Immediately prior to that I was Chairman of the Massachusetts Department of Public Utilities, and before that was Chairman of the Maine Public Utilities Commission. I have been an economist since 1965, and since 1980, when I became an industry economist at the FCC, have been directly involved with developing and establishing virtually all aspects of regulatory policy for telecommunications at the federal and state levels. While I was at the Massachusetts commission, that commission undertook a proceeding to examine in detail interconnection and other issues related to the development of competition at all levels of telecommunications. A copy of my curriculum vitae describing my educational and professional background in greater detail is attached.

II. PURPOSE OF AFFIDAVIT

2. SBC Communications Inc. and its subsidiaries Southwestern Bell Telephone Company (SWBT) and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance (SBLD) -- collectively, "Southwestern Bell" -- seek authority for SBLD to provide in-region, interLATA services in the State of Oklahoma. The central focus of this proceeding is whether allowing SBLD to originate interLATA calls in Oklahoma would benefit Oklahoma customers and would be in the public interest. I conclude that it most certainly would.

3. Up until a little over one year ago, the Bell Operating Companies (BOCs), including Southwestern Bell, were prohibited -- absolutely -- from offering interLATA services. Then, in a fundamental shift in policy, Congress passed the Telecommunications Act of 1996, which recognizes that maintaining barriers to entry by the BOCs into the interLATA market is fundamentally antithetical to its pro-competitive policies in telecommunications, and lays out the standards and processes for BOCs to enter the interLATA market on a state-by-state basis. This affidavit outlines in detail the reasons why approval of Southwestern Bell's petition for authority to offer interLATA service originating in its region is in the public interest.

4. The first section of the affidavit explains why compliance with the Act's requirements should provide the Commission with considerable confidence that SBLD's offering of interLATA services in Oklahoma will benefit consumers and will not harm competition in either the interLATA market or the local exchange market.

5. The last section of the affidavit considers the potential benefits and the alleged costs of entry in greater detail, and evaluates the Act's "public interest" standard. I then demonstrate that the benefits of allowing SBLD to originate interLATA service in Oklahoma clearly outweigh any plausible risks associated with a local exchange carrier participating in a market for which it supplies an essential input.

III. INTRODUCTION

6. A primary goal of the Act is to allow open competitive entry, by all participants, into all telecommunications markets, including both the local exchange market and the interLATA toll market. In order to accomplish this goal, Congress prescribed the removal of all barriers to entry, whether those barriers are judicial, economic, or regulatory. One of the critical legal entry barriers that Congress targeted for removal was the judicial (MFJ) barrier to Bell Operating Company (BOC) entry into the interLATA marketplace. Congress allowed BOCs to offer out-of-region interLATA services immediately, but provided certain standards that BOCs have to meet -- on a state-by-state basis -- in order to receive authority from the FCC to originate interLATA service in any in-region state.

7. As a result of SWBT's compliance in Oklahoma with the Act's conditions for interLATA entry, and given marketplace and regulatory conditions in Oklahoma, Southwestern Bell's entry into the interLATA market clearly is in the public interest. Some may argue that the Commission should not grant Southwestern Bell's petition, even if SWBT has met all of the conditions in the Act, because the local exchange market in Oklahoma is not yet subject to sufficient competition. Others may argue that the petition should be denied because SWBT's regulated switched access prices currently are set to recover costs over and above those directly incurred in providing switched access service. These parties may advocate that Southwestern Bell's petition not be granted until competitive local exchange carriers have achieved a specified market share or until the Commission completes and implements its recently opened investigation into access charge reform. None of these arguments should persuade the Commission. As I will discuss in further detail below, each of these arguments is flawed because each is based on the incorrect premise that there cannot be efficient competition and efficient entry during the transition from an industry characterized by monopoly regulation to a fully competitive market. Efficient competition and entry have occurred in other telecommunications markets, such as cellular and intraLATA toll. Given the ubiquitous

regulatory protections that are in place, it will also occur in the interLATA market even where one market participant is, at least for the time being, the largest supplier of an essential input.¹ This remains the case even when that input is priced by regulators to recover more than the incremental cost of access.

8. In addition to reviewing SWBT's compliance with the specific requirements in the Act for BOC interLATA entry, the Commission also must consider whether such entry is in the public interest. The public interest should be judged on the basis of the net benefits customers in Oklahoma would enjoy as a result of having the option available to them of choosing SBLD for their interLATA business. Giving Oklahoma customers the option of choosing SBLD as their interLATA service provider is likely to increase significantly the degree of competition for interLATA services in Oklahoma, and thereby lead to benefits for those customers in the form of lower rates, improved customer service, and more service options. These are the benefits of granting the petition. Theoretical problems are the claim that Southwestern Bell could subsidize the prices charged by its interLATA affiliate with revenues derived from its local exchange services, or discriminate in the provision of local exchange access in favor of its interLATA affiliate.

9. However, as the Commission itself found in its Orders on the Act's accounting and non-accounting safeguards, implementation of the Act's many regulatory safeguards for BOC interLATA entry, coupled with existing state and federal regulation, will be sufficient to prevent Southwestern Bell from pursuing strategies to artificially advantage its affiliate in the interLATA market.² Therefore, any likely risks of granting this petition clearly are not

¹ One observer has remarked: "It is difficult to imagine a regulatory strategy, other than a permanent complete ban on entry into allied markets, for coping with the possibility of predatory cross-subsidization and discriminatory interconnection by Bell operating companies that is not employed, at one point or another, in the 1996 Act." Thomas G. Krattenmaker, *The Telecommunications Act of 1996*, 49 Federal Communications Law Journal 20 (Nov. 1996) (footnote omitted).

² FCC 96-489, Report and Order, CC Docket No. 96-149, ¶ 13. FCC 96-490, Report and Order, CC Docket No. 96-150, ¶ 275.

sufficient to forego the benefits for Oklahoma customers that will flow from a favorable response to Southwestern Bell's petition.

IV. INTERLATA ENTRY REQUIREMENTS AND PROCESS

10. There are four important points to remember about the process and substantive standards established by Congress for BOC interLATA entry: (1) Conditions that must be met before entry are carefully laid out; (2) both operating and compliance standards for continued fair competition are provided; (3) procedures by which interested parties, particularly competitors, can monitor compliance are provided; and (4) regulators are provided with effective tools of enforcement.

11. As a prerequisite to applying for interLATA entry, the Act requires a BOC to have executed "one or more binding [interconnection] agreements that have been approved under section 252," Act, § 271(c)(1)(A), or to have received approval by the State commission of a statement of generally available terms and conditions. Act, § 271(c)(1)(B).

12. Another requirement in the Act for BOC interLATA entry is compliance with the interconnection checklist, which consists of some fourteen requirements. The checklist roughly corresponds to, but in some respects goes beyond, the interconnection requirements in section 251 of the Act. The checklist is a catalogue of those interconnection requirements that Congress deemed to be the necessary and sufficient³ prerequisites for BOC interLATA entry.

13. The significance of the Act's conditions for entry relate to how they demonstrate the opening of the local exchange to competition. First, Section 253 of the Act eliminates formal entry barriers outright. In addition, by requiring incumbent LECs to resell their offerings at wholesale rates, and to make available to competitors unbundled network elements on a forward-looking cost basis, the Act reduces economic barriers to entry that might otherwise have existed. When combined with meeting the checklist, these requirements create

³ Congress specifically directed the Commission not to "limit or extend the terms used in the competitive checklist." Act, § 271(d)(4). For a list of the specific requirements, see Section 271 of the Act.

open entry conditions that provide a strong assurance that BOCs will not engage in anticompetitive activity.

14. Under the Act, it is the conditions for open entry, rather than entry itself or achievement of any specified level of competition, that are most important in terms of determining whether an incumbent LEC will be able to engage in anticompetitive behavior. Economic theory recognizes, and empirical evidence confirms, the disciplining effect of open entry conditions. For example, when considering how to appropriately measure market power, the Merger Guidelines of the Department of Justice and Federal Trade Commission consider two effects. First, an analysis of the relevant market must include

“other firms not currently producing or selling the relevant product in the relevant area [are treated] as participating in the relevant market if their inclusion would more accurately reflect probable supply responses.”⁴

Such firms must be likely to enter profitably within one year in response to a small but significant margin between market price and cost and without any expenditure of significant sunk costs of entry. Second, over a longer period, the Guidelines consider

“the timeliness, likelihood, and sufficiency of the means of entry...a potential entrant might practically employ.”⁵

15. In addition to specifying conditions that must be met with respect to interconnection, the Act also requires the BOCs to establish structurally-separate affiliates (i.e., separate from the local exchange carrier operating companies), for at least three years, for the provision of interLATA services. Both the FCC and the Oklahoma Commission have significant experience since divestiture with regulating affiliate transactions in order to prevent anti-competitive behavior and subsidization. The FCC concluded that its existing affiliate

⁴ The U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, April 2, 1992, § 1.32 at 20-21.

⁵ Ibid., § 3, at 50.

transaction rules (with some minor modifications) were sufficient for implementing the Act.⁶ State regulatory commissions, including the Oklahoma Commission, have had significant experience with affiliate transactions of the Bell Operating Companies.

16. Although they will for a time cause Southwestern Bell and its customers to forego some of the potential economies of scope and scale, the Act's separate affiliate requirements (particularly as interpreted by the FCC in its recent order in CC Docket No. 96-149) will give extra protection to interLATA competition by requiring the otherwise integrated BOC to conduct operations and bookkeeping separately for the local exchange carrier and the new interLATA service. This requirement establishes a barrier between the BOCs' provision of services similar to that which currently exists between the BOCs' local exchange carriers and their cellular affiliates, and simplifies the regulators' task. In all my years as a state regulator, there was not one instance of the non-BOC cellular license holder arguing that the BOC discriminated in favor of its cellular affiliate. Note that demand for cellular service grew from just over 1.2 million subscribers in 1987 to more than 24 million subscribers at the end of 1994, and cellular service revenues grew in that same period from just over one billion dollars to over 14 billion dollars.⁷ Given such growth, what better, more profitable, place could there have been for a BOC to have discriminated in favor of its own affiliate than cellular, yet such discrimination was not alleged *even once* in the time that I was a state regulator. I see no reason to expect that the separate affiliate rules in the Act for BOC interLATA service will not have the same success.

17. The Act also contains a comprehensive set of audit and non-discrimination requirements, some of which must be maintained even after the separate affiliate requirement

⁶ "The Order also adopts the tentative conclusion in the *NPRM* that our current affiliate transactions rules generally satisfy the Act's accounting safeguards requirements when incumbent local exchange carriers, including the BOCs, are required to, or choose to, use an affiliate to provide services permitted under sections 260 and 271 through 276. The Order adopts most of the *NPRM*'s proposed modifications to the affiliate transactions rules to provide greater protection against subsidization of competitive activities by subscribers to regulated telecommunications services." FCC 96-490, Report and Order, CC Docket No. 96-50, ¶ 1.

⁷ 1995 Statistical Abstract of the United States, 115th Edition, page 575, Table No. 905.

sunsets.⁸ In terms of the auditing provisions, Southwestern Bell will be required to submit to detailed audits in order to ensure that they are complying with the Act's affiliate transaction rules and with the Commission's accounting safeguards. Thus, in addition to the continuing oversight of federal and Oklahoma regulators and competitors, the Act adds an independent auditor to the list of those who will be monitoring Southwestern Bell's activity to ensure that there will be fair competition in the interLATA market. The National Association of Regulatory Utility Commissioners has already prepared audit guidelines for implementation of this provision and has adopted a resolution in support of those guidelines.⁹

18. The antidiscrimination regulations in section 272(e) will work to protect competition in the interLATA market by requiring that SWBT provide local access to all interLATA carriers, including itself or its affiliate, at exactly the same rates, terms, and conditions. While this is not a new concept for regulators to enforce because it is tantamount to the existing requirements of common carriage, its application here reinforces the ability of regulators to protect interLATA competition.

V. SOUTHWESTERN BELL'S COMPLIANCE WITH THE ACT'S REQUIREMENTS

19. As Congress recognized, state regulators are capable of interpreting the Act's interconnection requirements and implementing them for the promotion of open competitive markets, and the Oklahoma PSC has done so in this case. For example, the Oklahoma PSC recently (December 12, 1996) has approved an arbitrated interconnection agreement between SWBT and AT&T.¹⁰ Second, the decisions made by the Oklahoma PSC are generally similar

⁸ The Act "sunsets" the separate affiliate requirement for BOC manufacturing and long distance after three years, unless the Commission extends the affiliate requirement by rule or order. Act, § 272(f)(1).

⁹ "Resolution to Support the Attached Audit Guidelines and Analysis to Comply with the Current Federal Legislation to Prevent Cross Subsidization," adopted at the 1996 NARUC Summer Committee Meeting, Los Angeles, CA.

¹⁰ Order No. 407704, Application of AT&T Communications of the Southwest, Inc., for Compulsory Arbitration of Unresolved Issues with Southwestern Bell Telephone Company pursuant to § 252(b) of the Telecommunications Act of 1996, Order Regarding Unresolved Issues, December 12, 1996.

to the Commission's own findings. For example, in the SWBT/AT&T decision, the Oklahoma PSC adopted a 19.8% wholesale discount, which is within the range established by the FCC.¹¹

VI. THE PUBLIC INTEREST STANDARD

20. Once compliance with the Act's specific requirements has been demonstrated, the only remaining question for the Commission in ruling on this petition relates to whether interLATA entry is in the public interest. This standard requires the Commission to find that "the requested authorization is consistent with the public interest, convenience, and necessity." Act, § 271(d)(3)(C). This public interest standard is best understood as a straightforward proceeding to evaluate whether the benefits to the public of Southwestern Bell's interLATA entry outweigh any possible risks associated with such entry. The clear focus of this inquiry should be on the interLATA marketplace in Oklahoma.

21. First, it must be recalled that in the Act, Congress has declared that open entry into all telecommunications markets is in the public interest. That fundamental policy choice has been made and is no longer at issue. The FCC has acknowledged that the central purpose of the Act is to "bring to consumers of telecommunications services in all markets the full benefits of vigorous competition." See FCC 96-489, First Report and Order, CC Docket No. 96-149, ¶ 7. Therefore, the public interest generally is served by the participation of willing companies, particularly experienced companies like Southwestern Bell who have demonstrated expertise in the provision of telephone service, in all telecommunications markets. The only way that maintaining a barrier to their entry into long distance could be in the public interest is if their participation is likely to have a negative impact on competition that exceeds the benefits it brings to the market. This inquiry should rely upon practical experience, not just theory or speculation. The evidence of actual competition in the intraLATA toll and cellular markets, where SWBT already provides essential inputs, and where no problems have arisen, strongly indicates that existing regulation, coupled with the new requirements and regulatory tools in the

¹¹ Id., Report and Recommendations of the Arbitrator, p. 19.

Act, is sufficient to ensure that competition in the interLATA market will not be harmed by participation by the BOCs.

A. The Benefits of Entry

22. No one can presume to predict exactly what shape the benefits of BOC entry in the interLATA market will take. But it is likely, based on our knowledge of the previous protected markets that have been opened to competition, that these benefits will take the form of price reductions, new marketing programs, bundled service offerings, better customer service, and innovative new or improved services. Only the competitive process itself can determine the specific elements of service that each provider offers or the unique efficiencies that each provider brings to the marketplace. Nevertheless, I have seen evidence strongly suggesting that BOC entry into the interLATA market could result in significant price decreases in current interLATA rates.¹² Given this, it is difficult to conceive that the addition of SBLD to a telecommunications market that is currently dominated by only three large, facilities-based carriers, will not bring significant benefits to consumers. In particular, I expect SBLD's entry to benefit residential, low-volume interLATA customers, who still, over ten years after the break-up of AT&T, have not benefited from existing interLATA competition to the extent that higher-volume customers have. Those customers have not had access to the volume-based discount plans offered by the incumbent IXC's, and their rates in fact have even been increased several times in the last few years. Evidence from markets where ILECs currently offer interLATA services strongly suggests that SBLD's entry will extend the benefits of competition to these low-volume customers:

- Under exceptions to the MFJ, Bell Atlantic competes with interexchange carriers in the New Jersey - New York and New Jersey - Philadelphia "corridors." As of July 1995,

¹² Paul W. MacAvoy, The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services (The MIT Press and The AEI Press) 1996, pp. 179-183,

Bell Atlantic's basic rates were 20 to 30 percent lower than those of the three largest IXCs.¹³

- As of July 22, 1996, SNET's prices for non-discount customers in Connecticut were 29.8 percent lower than AT&T's prices. Across all customers, SNET's prices were about 22 percent lower.¹⁴

23. First, competition clearly is not yet as expansive as it could be in the interLATA market. Thirteen years after divestiture, the "Big 3" carriers (AT&T, MCI, and Sprint) still control about 90% of the market between them, and often appear to be raising their prices in lock-step.¹⁵ Only recently has another carrier, LDDS/WorldCom, begun to approach the scope and size of the smallest of the three carriers. It also seems quite likely that there is room for price reductions in current long-distance rates.¹⁶

24. Second, Southwestern Bell has substantial experience as a telephone company particularly familiar with customers and their needs in the Oklahoma marketplace, and, therefore, is likely to be an active and effective competitor in the Oklahoma interLATA market on the basis of price, quality, customer service, and reliability. Just as AT&T and MCI have proven to be effective in Internet services, voice messaging, and other communications-intensive markets outside their traditional sphere of long-distance, Southwestern Bell should be able to make use of what it has learned in the local exchange and intraLATA toll business, with regard to marketing and administrative services, to make it an extremely effective competitor in the Oklahoma interLATA market, even while the Act's separate subsidiary requirement still is

¹³ "Bell Atlantic Seeks Nondominant Status in 'Corridor,'" *Telecommunications Reports*, July 17, 1995.

¹⁴ Hausman, Jerry, Hearing "Economic Forum: Antitrust And Economic Issues" held at July 23, 1996 at the FCC, pp. 69-70.

¹⁵ MacAvoy (1996), p. 83. "By the end of 1993 AT&T had 65 percent, while MCI and Sprint together had 29 percent of interLATA service revenues."

¹⁶ Kenneth Gordon, Alfred E. Kahn, and William E. Taylor, "Economic Competition in Local Exchange Markets," (1996). "AT&T's reported revenue per minute averaged 18 cents in 1994, when its reported carrier access payments averaged 6 cents per (conversation) minute. Incremental toll costs are estimated at 1 - 2 cents per minute and carrier access incremental costs have been estimated at roughly half that level (per conversation minute)." (footnotes omitted).

in effect. A wider range of economies of scope and scale can likely be used by SBLD to end the “follow the leader” pattern of rate increases, which have prevailed in the interLATA marketplace almost ever since divestiture.

25. Third, Southwestern Bell should be able to take advantage of any economies of scale and scope that it may have “from the LEC up” (*i.e.*, while SWBT and SBLD are prohibited from using any integrative efficiencies in their own operations, they can use those efficiencies derived from sharing a parent corporation), in order to lower rates for customers. The type of efficiencies that Southwestern Bell will be able to take advantage of generally fall under the heading of administrative and support services. In fact, the FCC recently has found that such efficiencies should be allowed for the BOCs.¹⁷ There may be still other economies of scope and scale in terms of the services provided to both the local exchange carrier and interLATA affiliate by the BOC parent corporation, as well, such as general corporate overhead and joint marketing opportunities. In fact, the FCC recognized the potential for such economies when it noted that a goal of its proceeding to implement accounting safeguards for BOC provision of interLATA service was to “preserv[e] for the benefit of interstate telephone ratepayers legitimate economies of scope that could be realized by BOCs and other incumbent local exchange carriers when entering markets from which they were previously barred or in which they continue to participate.” See FCC 96-490, Report and Order, CC Docket No. 96-150, ¶ 13.

26. Finally, customers are increasingly demanding “one-stop” shopping for communications services. The Commission itself has recognized that “[a]s firms expand the

¹⁷ “Based on the record before us, we decline to prohibit the sharing of services other than operating, installation, and maintenance services, ... We find that, if we were to prohibit the sharing of services, other than those restricted pursuant to section 272(b)(1), a BOC and a section 272 affiliate would be unable to achieve the economies of scale and scope inherent in offering an array of services.” FCC 96-489, First Report and Order, CC Docket No. 96-149, ¶ 178-183.

The Commission also recently noted that efficiencies derived from the merger of SBC and Pacific Telesis may make the long distance market “somewhat more competitive and efficient.” Applications of Pacific Telesis Group and SBC Communications, Inc., FCC No. 97-28, ¶ 74 (rel. January 31, 1997).

scope of their existing operations to new product lines, they will increasingly offer consumers the ability to purchase local, intraLATA, and interLATA telecommunications services, as well as wireless, information, and other services, from a single provider ..., and other advantages of vertical integration." See FCC 96-489, Report and Order, CC Docket No. 96-149, ¶ 7.¹⁸ The Commission also stated that "BOCs and other firms, most notably existing interexchange carriers, will be able to offer a widely recognized brand name that is associated with telecommunications services." *Id.* Surveys have shown that many customers want to buy a full range of communications services from one company and pay for it on one bill.¹⁹ MCI already has begun to heavily market a bundled service package called "MCI One," with the motto "One company, one number, one box, one bill. It's that simple."²⁰ AT&T also has announced its own package of services called "AT&T.ALL."²¹ The desire to provide one-stop shopping is also seen as a driving force behind some recent mergers of competitors to the BOCs.²²

27. In Oklahoma, SBLD will be an effective competitor of AT&T, MCI, and other companies, who are already offering such packages, to match or better those companies'

¹⁸ See, also, Applications of Pacific Telesis Group and SBC Communications Inc., FCC No. 97-28, ¶ 48 (rel. January 31, 1997). "[T]he bundling of local access and long distance services -- a form of one-stop shopping -- may be a desirable feature for some customers" (footnote omitted).

¹⁹ A recent J.D. Power study found that two thirds of all consumers surveyed said they would prefer to buy all service from their interexchange service company. Communications Daily, 9/5/96, p. 4.

²⁰ MCI indicates in its advertising that "[o]nly MCI One offers you all of today's communications options - calling, cellular, paging, Internet, and e-mail - and wraps them together in one convenient package." <http://www.mci.com/mcione/indexabout.shtml> (November 5, 1996).

²¹ "Following MCI's lead, AT&T launched a new service to provide business customers with a one-stop shop. The service, called AT&T.ALL, provides features such as one-stop customer care and consolidated billing to businesses subscribing to AT&T long distance and a wide array of AT&T services and calling plans." "AT&T Joins Full-Service Trend," X-Change, November 1996, page 29.

²² "The big fight for long-distance customers in the U.S. has largely given way to a battle by carriers over which will be the first to offer a bundle of local, long-distance, wireless and Internet services all on the same bill." John J. Keller "BT-MCI Merger Reshapes Telecom Industry," Wall Street Journal, November 5, 1996, page B1.

"This [merger] will make the new firm, MFS WorldCom, the first American telephone company since AT&T's breakup in 1984 to offer customers every sort of telephony: local, long-distance and (since this is 1996) Internet access. One-stop shops are said to represent the future of the telecoms business." "Two Davids Join," The Economist, Vol. 340, No. 7981, August 31, 1996.

service offerings and marketing. The fact that AT&T and MCI, well established companies with significant brand recognition, have a clear head start in making bundled offerings, coupled with state and federal regulations, means SBLD would have no unfair marketing advantage in offering "one-stop shopping," for which it would begin with zero market share.

B. The Alleged Risks of Entry

28. Having spent eight years in the Commission as an industry economist, and seven more years as the Chairman of two state public utility commissions, I can attest that the expertise of regulators in ensuring fair competition is far superior to what it was at the time of divestiture. Throughout most of the period of traditional regulation, monopoly structure was presumed: there was no occasion to make use of pro-competitive tools. Such is no longer the case, and has not been for some time. Since divestiture, regulators have become adept at using price regulation, imputation requirements, audits, competitive price analyses, and other tools to ensure that incumbent telephone companies do not use their monopoly control of essential access facilities to anticompetitive effect in competitive retail markets. The Commission itself since divestiture has augmented its economic expertise (as opposed to other regulatory skills, such as accounting and engineering), and has even changed the name of its Tariff Division to the Competitive Pricing Division. Even without taking into account any of the new regulatory safeguards in the Act, state and federal regulators are capable of preventing anticompetitive BOC activity in the interLATA market using their existing (i.e., pre-Act) regulatory tools and expertise.

29. The FCC has identified the two ways in which monopoly control of essential local exchange facilities might, in theory, be used to harm competition in the interLATA market: (1) anticompetitive misallocation of costs; and (2) LEC discrimination in favor of the BOC affiliate's interLATA services (see FCC 96-489, First Report and Order, CC Docket No. 96-149, ¶¶ 10-11). Neither one is at all likely to be a problem in the current market and regulatory environment.

1. Misallocation of costs

30. It is worth reviewing how regulators use existing regulatory tools and processes to control the allocation of costs. For example, the Commission currently uses weighted dial equipment minutes to allocate a higher proportion of small telephone companies' local loop costs than would be justified solely by cost considerations to the interstate jurisdiction, in order to help keep basic local service rates low for the customers of these companies. Such an allocation may, in fact, play a role in preventing competition for those customers' basic local service because potential competitors will find it difficult or impossible to compete with a subsidized price, but it is not an "anticompetitive" misallocation in the sense identified by the Commission as a concern. In terms of concerns related to BOC service in competitive markets, anticompetitive misallocation of costs should be understood to mean the assignment by the firm to monopoly services of costs that are properly attributable to the provision of a competitive service. Precisely because regulators have experience with consciously and purposefully using the allocation of costs for social purposes, they are likely to be more adept at recognizing anticompetitive pricing. Regulators' intimate experience with, and knowledge of, cost accounting mechanisms for ratesetting has prepared them well to identify circumstances where prices are set below incremental cost.

31. The Commission has noted that if a BOC is regulated under rate-of-return regulation, a price caps structure with sharing, a price cap scheme that adjusts its components according to actual changes in industry productivity, or if its revenue recovery is based on costs recorded in regulated books of account, that BOC may have an incentive to allocate costs associated with its interLATA service to its core regulated business (see FCC 96-489, First Report and Order, CC Docket No. 96-149, ¶ 10). These are well understood problems of traditionally regulated settings. SWBT has chosen the FCC's no earnings sharing option with a higher productivity offset for the regulation of its interstate rates, but is still regulated in the intraLATA market in Oklahoma under rate-of-return regulation. However, the FCC has noted several times in recent Orders that its existing rules, as modified to conform with the new Act, are sufficient to prevent subsidization and misallocation of costs:

Our cost allocation and affiliate transactions rules, in combination with audits, tariff review, and the complaint process, have proven successful at protecting regulated ratepayers from bearing the risks and costs of incumbent local exchange carriers' competitive ventures. FCC 96-490, Report and Order, CC Docket No. 96-150, ¶ 25.

In agreement with most commenters, we adopt our tentative conclusion that, except where the 1996 Act imposes specific additional requirements, our current affiliate transactions rules generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services. We have previously concluded that these rules provide effective safeguards against cross-subsidization. *Id.*, ¶ 108.

We conclude that the accounting safeguards that we adopt in this Order with respect to sections 260 and 271 through 276 are sufficient to implement section 254(k)'s requirement that carriers not "use services that are not competitive to subsidize services that are subject to competition." Our existing accounting safeguards, with the modifications that we adopt in this Order, prevent subsidization of competitive nonregulated services, such as those addressed in Sections 260 and 271 through 276 by subscribers to an incumbent local exchange carrier's regulated telecommunications services. *Id.*, ¶ 275.

32. The Commission has concluded that the requirements in the Act, supplemented by its findings in the 130 page Order implementing accounting safeguards, are sufficient to prevent cross-subsidization and misallocation of costs. It should now be prepared to rely on these safeguards. The Oklahoma Commission also has recently adopted parallel regulations prohibiting subsidization of competitive services and establishing imputation standards.²³

33. Another argument advanced by the incumbent IXC's is that, as long as BOC switched access service is priced above incremental cost, there is a non-traditional price squeeze that BOCs can apply to unaffiliated competitors in the interLATA market (see Franklin

²³ Oklahoma Corporation Commission Rules, Chapter 55: "Telecommunications Services," OAC 165:55-17-27(d) and (e), effective July 1, 1996.

M. Fisher, "An Analysis of Switched Access Pricing and the Telecommunications Act of 1996"). According to this theory, a Bell Operating Company within its region will price its interLATA service lower than it would outside the areas where its local exchange affiliate provides access service, and thus forego revenues in the interLATA market, in order to lower the market price for all suppliers to stimulate additional usage -- and, consequently, additional access revenues for itself. Such an incentive for vertically-integrated BOCs to lower prices more than they would if they were not integrated is better characterized as the exercise of competitive profit-maximizing behavior than as predation. In fact, in any market, the firm will take into account the interactions between related submarkets. This price reduction has been pointed to by some as actually being a beneficial aspect of allowing BOCs into the interLATA market, and not a detriment to competition.²⁴ Surely, to the extent that they are not anticompetitive, lower prices are one of the benefits for consumers of increased competition in any market, and the Act contains sufficient safeguards to prevent BOCs from pricing their interLATA service anticompetitively.

34. Moreover, while this non-traditional competition argument identifies a possible theoretical incentive for the BOCs to price lower than they would were these not integrated markets, in practice the strategy only works in certain specified conditions that are unlikely to occur. In order for it to be profitable for a BOC to forego interLATA revenues in exchange for additional access revenues, the BOC must have a relatively low interLATA market share in order to ensure that it is not foregoing too much revenue. However, the BOC's market share must nevertheless be high enough for the BOC to influence the market price in order to stimulate overall demand to generate access revenues. In other words, in order for this strategy to work, the BOC's market share cannot be too low and cannot be too high -- like Goldilocks's porridge, it must be "just right." The likelihood of the BOC knowing what the "just right" market share is, and then manipulating the market in such a way as to achieve that level is not

²⁴ MacAvoy (1996), p. 179. David S. Sibley and Dennis L. Weisman, "The Competitive Incentives of Vertically Integrated Local Exchange Carriers: An Economic and Policy Analysis," April 1996 (Revised December 1996).

strong, particularly since the “just right” market share for any particular company is a function of the demand elasticity for interLATA service and the relative contribution in that company’s switched access prices.

2. Discrimination

35. The Commission has noted as well that “a BOC may have an incentive to discriminate in providing exchange access services and facilities that its affiliate’s rivals need to compete in the interLATA telecommunications services and information services markets.” See FCC 96-489, First Report and Order, CC Docket No. 96-149, ¶ 11. However, as with the risk of subsidization and misallocation of costs, the Commission has already concluded that its existing rules, again supplemented with additional requirements adopted in compliance with the Act in a 185 page Order, are sufficient to minimize the potential for such discrimination:

We believe, however, that sufficient mechanisms already exist within the 1996 Act both to deter anticompetitive behavior and to facilitate the detection of potential violations of section 272 requirements. FCC 96-489, First Report and Order, CC Docket No. 96-149, ¶ 321.

We believe that the reporting requirements required by the 1996 Act, those required under state law, and those that may be incorporated into interconnection agreements negotiated in good faith between BOCs and competing carriers will collectively minimize the potential for anticompetitive conduct by the BOC in its interexchange operations. In addition to deterring potential anticompetitive behavior, these information disclosures will also facilitate detection of potential violations of the section 272 requirements. *Id.*, ¶ 327.

36. However, even without the new requirements and prohibitions in the Act, regulators today are certainly capable of preventing BOCs from discriminating in favor of their own affiliates in the provision of exchange access, particularly given the ever-vigilant eyes and ears of the BOCs’ competitors who are also always on the lookout for such activity. In fact, some state regulators for years have successfully monitored BOC activity in the intraLATA toll market, where BOCs have competed with IXCs with fewer regulatory safeguards than will be in place in the interLATA toll market.

37. The ability of competing IXC's to use unbundled network elements as an alternative access path to any customer also makes it difficult for BOC's to discriminate. In its recent interconnection decision, the Commission stated, "We confirm our tentative conclusion ... that section 251(c)(3) [of the Act] permits interexchange carriers and all other requesting telecommunications carriers, to purchase unbundled elements for the purpose of offering exchange access services, or for the purpose of providing exchange access services to themselves in order to provide interexchange services to consumers." FCC 96-325, First Report and Order, ¶ 356. Therefore, a carrier competing with SBLD can purchase an unbundled local loop, and any other necessary network elements, for exchange access to any of SWBT's current customers for the purpose of providing its own or other carriers' interexchange services to that customer. A carrier pursuing such a strategy, once it has limited facilities of its own, has few, if any, sunk costs. As already noted above, a number of agreements have already been signed -- and several of these approved by the Oklahoma Commission.

38. It is worth emphasizing that BOC's have not discriminated in the cellular market where they control an essential input and an affiliate competes against unaffiliated companies. The local exchange carrier in those markets clearly has not favored the BOC's affiliated cellular company, even though they theoretically would have the incentive to do so. If BOC's were favoring their affiliated cellular providers, presumably the BOC's themselves would be reluctant to provide cellular service in other regions where they would be competing against the wireline carrier's affiliate. In fact, BOC cellular companies, including Southwestern Bell Mobile Systems, an affiliate of SBC Communications Inc., aggressively and successfully compete against the wireline affiliate in many regions throughout the U.S.

39. IntraLATA toll is another good example of how regulation since divestiture has ensured that a vertically-integrated firm competes fairly in the retail market. There have been fewer safeguards in the intraLATA toll market than will exist in the interLATA market, yet IXC's have chosen to compete in the intraLATA markets for years. IntraLATA service is not incidental for IXC's -- they have had to decide whether or not to compete in that market. When IXC's run through their litany of ways in which BOC's supposedly will be able to discriminate in